M/s. Sassoon J. David and Co. Pvt. Ltd., Bombay

Vs

C. I. T., Bombay (Civil Appeal No. 2501 of 1972) and M/S. Sassoon J. David and Co. Pvt. Ltd., Bombay

Vs

C. I. T. Bombay (Civil Appeal Nos. 2502-2504 of 1972).

Civil Appeal No. 2501

(E, S, Venkataramiah, N. L. Untwalia JJ)

03.05.1979

JUDGMENT

VENKATARAMIAH, J. -

1. Since these appeals by certificate involve a common question of law, we find it convenient to dispose them of by this common judgment.

2. Civil Appeal No. 2501 of 1972 is filed against the judgment of the High Court of Bombay in Income Tax Reference No. 58 of 1963 and Civil Appeal Nos. 2502-2504 of 1972 are filed against the judgment of that High Court in Income Tax Reference No. 87 of 1965. The assessee, M/s. Sassoon J. David & Co. Pvt. Ltd. (hereinafter referred to as 'the Company') is the appellant in all these cases and the assessment years are 1957-58, 1958-59, 1959-60 and 1960-61, the relevant calendar years being 1956, 1957, 1958 and 1959 respectively.

3. The Company is an investment company and its shares were originally held either directly or through their nominees by Sir Percival David, Lady David and Mr. V. P. David (hereinafter collectively referred to as 'Davids'). The issued capital of the company consisted of 1000 ordinary shares of the face value of Rs. 10,000 each. According to the valuation made by the auditors, the assets of the Company were worth Rs. 155 lacs as on December 31, 1955. At a meeting of the directors of the Company held on December 2, 1955, a resolution was passed recommending that the employees of the Company whose names were set out in the statement attached thereto be paid certain sums or annuity as set out against the names of each of them as and by way of retrenchment compensation and compensation for termination of employment and also for long and faithful services rendered by them to the Company in the past and that their services might be terminated. It was also resolved to call an extraordinary general meeting of the shareholders of the Company to consider and if though fit to approve the recommendation made by the directors as stated above. Accordingly a extraordinary general meeting of the shareholders of the Company was held on January 17, 1956 but it was adjourned to January 25, 1956. On the adjourned date, the meeting passed a resolution approving the recommendation made by the directors to pay the employees retrenchment compensation and compensation for termination of employment and also additional retrenchment compensation and compensation for termination of employment in the case of some of them and to terminate their services on or after April 1, 1956. Thereafter an agreement was entered

into between Davids and Tata Sons Ltd. (hereinafter referred to as 'the Tatas') on March 23, 1956 agreeing to sell the 1000 shares held by Davids or their nominees in the Company in favour of Tatas or their nominees for a sum of Rs. 155 lacs. The said agreement inter alia provided that the sum voted by the Company for payment of gratuities and/or as compensation for loss of employment to existing directors and employees of the Company with respect to their services up to and inclusive of March 31, 1956 and a further amount of Rs. 16,188 payable to the Managing Director, Mr. Mathalone should be paid in accordance with the resolution by the Company and the amount so paid should be deducted from the purchase price of Rs. 155 lacs agreed upon. It also provided that Davids should arrange to terminate the services of all employees with effect from March 31, 1956 and also to arrange that all directors (including the Managing Director) resign their offices and Tatas or their nominees should thereafter be entitled to appoint or elect all or any of the members should thereafter be entitled to appoint or elect all or any of the members of the staff and directors (including existing directors and members of the staff) of the Company as they deemed fit.

4. Of the 22 employees covered by the resolution of the directors dated December 2, 1955 followed by the confirmation at the extraordinary general meeting on January 25, 1956, 9 were re-employed and 13 persons were not re-employed. In the books of the assessee, there was a debit for a total sum of Rs. 1,64,899 during the accounting year 1956, the details for which were as follows :

> #Amount payable to the 22 employees as per resolutiondated December 2, 1955 and January 25, 1956 . . Rs. 1,04,626Amount described as "additional retrenchmentcompensation and compensation for terminationof employment and also for long and faithful services",as per resolution No. 2 dated January 25, 1956 . . Rs. 6,000Compensation for termination of pension allowance . . Rs. 21,200Annuity of Shri A. E. Joseph, former Director as perresolutions dated December 2, 1955 and January 25, 1956. Rs. 16,885Amount described as "compensation for loss of office ofManaging Director Mr. R. Mathalone". . . Rs. 16,188 ---------- Total : Rs. 1,64,899##

5. It should be mentioned here that A. E. Joseph, the former Director of the Company had to be paid as per the resolution of the Company Rs. 16,885 by way of annuity during a period of five years commencing with 1956.

6. During the assessment year 1957-58, the relevant previous year being 1956, the Company claimed deduction of Rs. 1,64,899 referred to above before the Income Tax Officer under Section 10(2)(xv) of the Indian Income-tax Act, 1922 (hereinafter referred to as 'the Act'). During each of the three succeeding assessment years with which we are concerned, the Company claimed deduction of Rs. 16,885 being the annuity paid to Mr. A. E. Joseph pursuant to the resolution. During the assessment year 1957-58, the claim in respect of the entire sum of Rs. 1,64,899 was disallowed by the Income-tax Officer on the ground that the services of the directors and employees had been terminated not because of business expediency but because Tatas, the purchasers of the shares made it a condition under the agreement. The relevant part of the order read as follows :

> Thus, it emerges that the expenditure of the type of gratuity would be allowable under Section 10(2)(xv) only if the persons retiring had such expectancy or they accepted lower salaries in such expectation and hence it was an incentive to existing employees or future employees. Is against that we find that here even before the Tatas took up the management of the company, services of the employees and directors were terminated and the amount of compensation fixed. The fact that there

> was no expectancy or custom of such gratuity with the company is clearly borne out by the fact that many of the employees whose services are terminated had put in a number of years of service in some cases even going up to 40 years. As against this the assessee has been pleading that most of the employees were very old and that as a result of change of staff the Company was able to effect considerable economy. However, I understand that some of the old employees were reinstated and as stated the whole transaction was a part of the overall transaction of purchase of shares and passing over of control. The manner in which the services of all the employees under the old management were terminated is also significant. Thus I am unable to see how this expenditure can fall under Section 10(2)(xv). I am unable to find any distinction between compensation paid to employees and those paid to directors and also any distinction between outright compensation paid to a director and annuity paid to a director. None of the expenses are allowable and I add the whole amount claimed by way of gratuity, compensation for loss of employment and annuity or compensation for loss of office to a director or former director.

7. Aggrieved by the decision of the Income-Tax Officer, the Company filed an appeal before the Appellate Assistant Commissioner of Income-Tax. The Appellate Assistant Commissioner after taking into account the records before the Income-Tax Officer and the statement filed by the Company before him found that the Income-Tax Officer was right in disallowing the claim even though he was of opinion that the Company had by the termination of services of the directors and the employees by payment of gratuity and/or compensation been benefited. The relevant part of his order was as follows :

> The only contention remaining to be considered is that the Income-Tax Officer was wrong in disallowing a sum of Rs. 1,64,899 paid to certain employees and directors as compensation for termination of services. The circumstances leading to the payment of this compensation have been narrated in detail in the order of the Income-Tax Officer. It is strongly urged that the termination of the services of the persons concerned was of great benefit to the Company even considering the payment of the compensation since the establishment expenses were very substantially reduced as a result. From the information furnished to me, this statement is no doubt quite justified. However, it is seen that the termination of the services and the payment of compensation were not done wholly with a view to the business requirements of the company, but were bound up with the changing of hands of the shares of the company. According to the agreement for the sale of all the shares of the company. According to the agreement for the sale of all the shares of the company the sellers had to arrange to terminate the services of all the employees and also arrange that all directors resigned their offices. It is expressly stated that this requirement was to enable the purchasers to appoint or elect all members of the staff and directors. As a matter of fact some of the persons to whom compensation had been paid for termination of services were immediately re-employed by the Company. The decision to pay compensation cannot in the circumstances be said to have been taken solely with a view to the business requirement of the company though incidentally the company might have been benefited by it. In view of what has been stated above, I feel that Income-tax Officer was justified in his action. The appellant has referred to the Bombay High Court decision in the case of F.E. Dinshaw Ltd. (36 ITR 114 (Bom) : AIR 1959 Bom 427), but the facts in the present case are not identical with those of the case mentioned.

8. On further appeal to the Tribunal by the Company, the Tribunal affirmed the order of the Appellate Assistant Commissioner holding that the inference drawn by the Income-Tax Officer that the payments in question were motivated by the reorganisation of share holding had not been challenged by the Company; that the reference made to the said payments in the agreement of sale of shares led to such an inference and that the expenditure had not been incurred for the purpose of the Company but purely as a result of the bargain between Davids and Tatas. It was further held by the Tribunal that even assuming that the payments were beneficial to the Company, no deduction could be allowed since they had been made to benefit third parties. Accordingly the Tribunal dismissed the appeal.

9. An application made under Section 66(1) of the Act before the Tribunal was rejected. Thereafter the Company filed an application before the High Court of Bombay under Section 66(2) of the Act and the High Court directed the Tribunal to state a case and to refer the following questions of law for its opinion :

> (1) Whether the Tribunal erred in law disallowing the amount of Rs. 1,64,899 as a deduction under Section 10 of the Indian Income Tax Act, 1922 ?
>
> (2) Whether there was any evidence to justify the Tribunal's finding that the payment of Rs. 1,64,899 or any part thereof was made in view of and in order to effectuate the agreement entered into between the old shareholders and the new shareholders and that the payment had no commercial purpose behind it ?
>
> (3) Whether in any event the sum of Rs. 16,188 paid to the Managing Director by way of pay in lieu of six months' notice was allowable as a deduction under Section 10 of the Indian Income Tax Act, 1922 ?

10. Accordingly, the Tribunal drew up a statement of the case and referred the above questions. Later on the Tribunal referred under Section 66(1) the following question of law arising out of the orders of assessment for the assessment years 1958-59, 1959-60 and 1960-61 in respect of the annuity paid to Mr. A. E. Joseph :

> Whether in computing the assessee's business income of the accounting years 1957, 1958 and 1959, relevant for the assessment years 1958-59, 1959-60 and 1960-61, the sum of Rs. 16,885 is an admissible deduction under Section 10(2)(xv) of the Act ?

11. It is not necessary to refer to the other matters involved in the orders of assessment of the years 1958-59, 1959-60 and 1960-61 and to the various stages of the cases until they reached the High Court.

12. Income Tax Reference No. 588 of 1963 [(1972) 82 ITR 83] arising out of the assessment proceedings of the year 1957-58 was heard by a Division Bench of the High Court Bombay and decided on February 5, 1970. The High Court found that out of Rs. 1,64,889 referred to in question No. 1 only a sum of Rs. 21,200 which was commutation of liability for payment of pension to some retired employees and/or widows of such employees and a sum of Rs. 16,188 paid to Mr. Mathalone, Managing Director in lieu of six months' notice that had to be given prior to termination of his service were allowable as deductions and that the Company was not entitled to claim deduction of the remaining sum of Rs. 1,27,511. It accordingly answered question No. 1 in the negative insofar as the sum of Rs. 1,27,511 (excluding two items of Rs. 21,200 and Rs. 16,188) was

concerned, question No. 2 in the affirmative insofar as the amount aggregating to Rs. 1,27,511 (excluding the two items of Rs. 21,200 and Rs. 16,188) was concerned and question No. 3 in the affirmative. The High Court was of the view that the expenditure of the sums amounting to Rs. 1,27,511 paid to the employees and a director of the Company by way of retrenchment compensation or compensation for termination of service had not been incurred by the Company for commercial expediency and/or considerations. It accordingly disallowed the claim made by the Company to the extent indicated above. The Income Tax Reference case arising from the assessment orders relating to assessment years 1958-59, 1959-60 and 1960-61 came before another Division Bench of the High Court and that Division Bench following the decision rendered by the High Court earlier disallowed the claim of the Company for deduction in respect of the payment of Rs. 16,885 to Mr. A. E. Joseph in each of the accounting years relative to the assessment years in question. Aggrieved by the judgments of the High Court of Bombay, the Company has filed these appeals.

13. We are concerned in these appeals with the claim of the Company in respect of a sum of Rs. 1,27,511 out of Rs. 1,64,899 referred to in question Nos. 1 and 2 in the reference relating to the assessment year 1957-58 and the claim in respect of payment of Rs. 16,885 made to Mr. A. E. Joseph during each of the three succeeding years. The undisputed facts of the case are : The shares of the Company were held by Davids or their nominees till they were transferred to Tatas : that according to the valuation made by the auditors of the Company, its assets were worth Rs. 155 lacs as on December 31, 1955; that at a meeting of the directors held on December 2, 1955, it had been resolved that the services of 22 employees should be terminated by paying retrenchment compensation, that on January 25, 1956 at the extraordinary general meeting of the shareholders of the Company, it was resolved that the employees of the Company be paid certain sums or annuity set out against the names of each of them and their services should be terminated with effect from April 1, 1956; that an agreement was entered into between Davids and Tatas on March 23, 1956 regarding the sale of the shares in favour of the Tatas; that the said agreement referred to the resolution passed at the meeting of the shareholders of the Company; that the Company paid retrenchment compensation according to the aid resolution and that the Tatas deducted from the purchase price the sum payable by the Company in accordance with the resolution of the Company from out of the consideration of Rs. 155 lacs which they had agreed to pay under the agreement dated March 23, 1956 to Davids. Apart from the resolution of the Board of Directors of the Company dated December 2, 1955, the resolutions passed at the extraordinary general meeting of the shareholders of the Company held on January 25, 1956, the agreement dated March 23, 1956 entered into between Davids and Tatas, the books of account of the Company showing payments made by the Company by way of retrenchment compensation and the fact that 9 of the 22 employees whose services had been terminated had been re-employed, there was no other evidence before the Income Tax Officer. The Income Tax Officer presumably because of the proximity of the dates of the resolutions, the date of the agreement and the dates on which retrenchment compensation was paid to the employees came to the conclusion that the retrenchment of the employees had been effected as a part of the bargain entered into between Davids and Tatas and therefore compensation paid to the employees on retrenchment of their services and to the director on the termination of his service had not been paid in the course of the business of the Company by way of commercial expediency. He accordingly disallowed the claim of the Company under Section 10(2)(xv) of the Act. Although the Appellate Assistant Commissioner in the course of his order observed that the Company had been benefited by reason of the retrenchment of the services of the employees as it had resulted in the reduction of the expenditure on the establishment, he disallowed the claim on the very same ground on which the Income Tax Officer had rejected it. The Tribunal

proceeded to dispose of the case before it on the basis that the inference drawn by the Income Tax Officer that the payments were motivated by the reorganisation in the shareholding had not been questioned by the Company either before the Appellate Assistant Commissioner or before it. We do not find in the order of the Appellate Assistant Commissioner that any concession had been made by the Company to the effect that the finding of the Income Tax Officer referred to above was correct. In the grounds of appeal before the Tribunal, the Company had stated that the Appellate Assistant Commissioner erred in holding that the decision to pay compensation cannot in the circumstances be said to have been taken solely with a view to the business requirement of the Company though incidentally the Company might have benefited by it.

The appellants submitted before the Tribunal that the above amount was expended wholly and exclusively for the purpose of their business and as such it should have been deducted as an admissible expense in computing their income liable to income-tax. The Tribunal while deciding the question whether the sums paid by way of compensation were deductible or not observed that the fact that a reference to payment to the staff of compensation had been made in the agreement led to the inference that such payment was a part of the bargain between Davids and Tatas; that on account of such payment, the purchasers had actually been benefited while the Company had to make payment in order to give effect to the agreement and therefore, there was no commercial purpose involved in making the said payment. The Tribunal also held that even assuming that the Company was benefited by payment of compensation by reason of reduction in its establishment expenses, since the payment had been made as a result of the bargain between Davids and Tatas, it could not be allowed as a deductible expenditure. It should be stated here that the Tribunal did not reverse the finding of the Appellate Assistant Commissioner that the Company had been benefited by such payment. In fact it did not go into the question whether the payment had really resulted in any benefit to the Company. The High Court, however, in the course of its judgment found that on account of the retrenchment of the employees and re-employment of only 9 of them, the yearly wage bill of the Company for salaries was reduced from Rs. 1,14,197 in 1955 to Rs. 67,268 in 1956 and thereafter in 1957 and 1958 respectively to Rs. 54,124 and Rs. 54,960.

14. In the instant case, it is necessary to bear in mind that the Company was neither dissolved nor was its business undertaking sold. It continued to exist as a juristic entity even after the transfer of its shares by Davids to Tatas. On account of such transfer of shares, the transferees no doubt gained control on the Company. But one important fact of the case which was lost sight of by the High Court and the Tribunal was that neither Davids nor Tatas derived any direct benefit out of the payment of retrenchment compensation to the employees even though such retrenchment might have facilitated the transfer of shares. It is also not the case of the Department that the payment was excessive. That there was a substantial reduction in the wage bill in the future years as a consequence of retrenchment was also not disputed. It is too late in the day now, whatever may have been the position about two decades ago, to treat the expenditure incurred by the management in paying reasonable sums by way of gratuity, bonus, retrenchment compensation or compensation for termination of service as not business expenditure. Such expenditure would ordinarily fall within the scope of Section 10(2)(xv) of the Act which authorised the deduction of any expenditure not being in the nature of capital expenditure or personal expenses of the assessee laid out or expended wholly and exclusively for the purpose of business or profession or vocation.

15. The High Court, however, declined to allow the deduction of the sums referred to above in these cases principally relying upon the decision of this Court in Gordon Woodroffee Leather Manufacturing Co. (1962 Supp 2 SCR 211 : 42 ITR 1962 SC 1361). The facts of that case were briefly thus : One J. H. Philips was the Director of the assessee Company in that case from the year

1940. On March 22, 1949, he wrote a letter to the assessee expressing his intention to resign from its Board as from April 4, 1949 and requested that his resignation be accepted. On March 24, 1949, the Board of Directors of the assessee passed a resolution that his resignation be accepted and in appreciation of his long and valuable services to the assessee, he be paid a gratuity of Rs. 50,000 out of which the assessee was to pay Rs. 40,000 and its Managing Agent was to pay Rs. 10,000. Subsequently the resolution was approved at the extraordinary general meeting of the assessee. Accordingly a sum of Rs. 40,000 was paid by the assessee to Mr. J. H. Philips. The assessee claimed deduction of the said sum of Rs. 40,000 under Section 10(2)(xv) of the Act. The Income Tax Officer as well as the Appellate Assistant Commissioner disallowed the said claim on the ground that the Company had no pension scheme; that the payment was voluntary and that the entry in the assessee's books clearly indicated that the payment was a capital payment. The Tribunal upheld the order of the Appellate Assistant Commissioner. It held that according to the resolution the gratuity was paid "for long and valuable services to the assessee", that there was nothing to indicate that Mr. J. H. Philips had accepted a lower salary in expectation of getting a gratuity at the end of his service; that during the course of his service, he was being remunerated at a graduated scale of salary and a commission of 2 1/2 % on the profits; that there was no "expectancy" that at the end of the service there would be recompense for a faithful and efficient service and that he had been suitably rewarded by being given a commission on the profits "in order to whip up his enthusiasm". It was also found by the Tribunal that in the books of the assessee, the amount had not been debited in the profit and loss account but was debited to the appropriation account thereby indicating that it was an extra payment or a payment made in that nature of a capital expense. On a reference under Section 66(1) of the Act, the High Court of Madras answered the question relating to the above item of expenditure against the assessee. On appeal, this Court affirmed the decision of the High Court. While holding that the claim made by the assessee did not satisfy the proper tests for claiming exemption under Section 10(2)(xv) of the Act, this Court observed as follows :

> In our opinion the proper test to apply in this case is, was the payment made as a matter of practice which acted the quantum of salary or was there an expectation by the employee of getting a gratuity or was the sum of money expended on the ground of commercial expediency and in order indirectly to facilitate the carrying on of the business. But this has not been shown and therefore the amount claimed is not a deductible item under Section 10(2)(xv).

16. After quoting in the course of it judgment the above passage, the High Court proceeded to observe as follows :

> Having regard to the test applicable in connection with the contentions made by Mr. Palkhiwala, what required to be investigated in whether the payments in question were made as a matter of practice which had affected the quantum of salary or whether there was an expectation by the employees (whose employment was terminated) of getting a gratuity or, in the alternative, the above sums were expended on the ground of commercial expediency and in order indirectly to facilitate the carrying on of the business.

17. After making the above observation, the High Court held that the Company had not placed any evidence to show that there was a practice in the Company to pay compensation even though its attention was drawn that in the past i.e. between 1964 and 1952, the Company had paid such compensation in two cases on the basis of one month's basic salary for each year of service. It also rejected the case of the Company that the amount involved had been expended on the ground of

commercial expediency and in order indirectly to facilitate the carrying on the business of the Company even though it observed that the yearly wage bill of the Company was reduced after such payment. The High Court held that the consideration of reduction of the wage bill was foreign to the decision taken by the Company to terminate the services of the employees and to pay them retrenchment compensation and observed that the purpose of the payment so far as could be ascertained from the contents of the resolutions of the Board of Directors and the Company when read with the relevant contents of the agreement for sale was the carrying out of the obligation arising under the agreement. It also held that the fact the expenses became reduced was insufficient to record a finding that the amount of retrenchment compensation was paid for commercial considerations or expediency. From the perusal of the judgment of the High Court it becomes clear that the High Court placed more emphasis on the motive with which the amount was expended than the fact that the expenditure had been incurred in connection with the business of the Company and that such expenditure resulted in the reduction of the annual wage bill of the Company in the future years.

18. In order to claim deduction under Section 10(2)(xv) of the Act, an assessee has to show that the expenditure in question (i) was not an allowance of the nature described in any of the clauses (i) to (xiv) of Section 10(2), (ii) was not in the nature of a capital expenditure or personal expenses of the assessee, and (iii) had been laid out or expended wholly and exclusively for the purposes of his business, profession or vocation. Even assuming that the motive behind the payment of retrenchment compensation was that the terms of the agreement of the sale of shares should be satisfied, as long as the amount had been laid out or expended wholly and exclusively or the purpose of the business of the assessee, there appears to be no good reason for denying the benefit of Section 10(2)(xv) of the Act to the Company if there is no other impediment to do so.

19. The facts of these cases are very close to the facts found in Commissioners of Inland Revenue v. Patrick Thomson Ltd. (in liquidation) : Commissioners of Inland Revenue v. J. & R. Allan Ltd. (in liquidation) : Commissioners of Inland Revenue v. Pettigrew & Stephens Ltd. (37 TC 145). The respondent-companies in the said cases were subsidiaries of a Company called Scottish Drapery Corporation Ltd., the control of which was acquired by the House of Fraser Ltd. Changes of organisation which were made in accordance with the policy of the House of Fraser Ltd. involved the termination of the contracts of service of the Managing Directors of the respondent-companies and also the eventual liquidation of those companies. Certain sums were paid by the companies to the managing directors in connection with the cancellation of their contracts, the payments being expressed in the first two cases to be in satisfaction of rights to future remuneration, and in the third to be in lieu of notice. Before the Special Commissioners, the companies contended that the payments made by them to the Managing Directors in connection with the cancellation of their contracts had been made to relieve them from onerous contracts and were allowable deductions. The Crown contended that the payments were not expenses of the companies' businesses but were incidental to the schemes by which those businesses were acquired by the House of Fraser Ltd. and were made primarily for the benefit of that company. The Commissioners, however, decided that the deductions claimed were allowable. Upholding the findings of the Commissioners, the Lord President observed at page 156 :

> In my opinion the contention put forward by the Crown is unsound and the Special Commissioners were correct in rejecting it. Admittedly in this case no question arises in regard to the words "wholly and exclusively", and if the Crown's contention is unsound it is not disputed that the disbursement in question falls within Section 137(a). To succeed in their contention the Crown must establish two matters. In the

first place it must show that the liquidation involved a discontinuance of the trade carried on prior to it by the respondent Company and the subsequent operation of a new trade carried on by House of Fraser. In the second place it must show that the expenditure in question was laid out for the purposes of the new trade. Without both these steps, its argument fails. In my opinion neither step in the argument is made out.

20. In the present case also, it is seen that the Company continued to function even after its control passed on to the hands of Tatas and the expenditure in question was laid out for the purpose of the Company's own trade and not for the trade of Tatas who were only the shareholders of the Company. We cannot overlook the distinction between the Company and its shareholders. As a result of the expenditure in question, the Company was in fact benefited and it was possible for it to earn more profits as a consequence of the reduction in the age bill. It was suggested in the course of the arguments before us that Tatas were actually benefited by the payment in question because the price payable by them for the shares was reduced by the amount spent by the Company. We do not find any substance in this contention. Admittedly the assets of the Company had been valued as on December 31, 1955 at Rs. 155 lacs which Tatas had agreed to pay. Subsequent to December 31, 1955, the Company had by passing the resolution incurred the liability to pay retrenchment compensation and compensation for termination of service as stated above. On account of the said resolution, the total value of the assets of the Company was reduced by the amount payable to the employees by way of compensation. It is natural that the purchaser of the shares would ordinarily claim reduction in the consideration payable for he shares by the amount which the Company had undertaken to pay as assets of the Company became reduced to that extent. It cannot, therefore, be said that the Tatas were in any way benefited financially by reason of the reduction in the consideration payable by them for the shares. We feel that the expenditure in respect of which deduction is claimed by the Company in this case falls within the third test laid down by this Court in the case of Gordon Woodroffee Leather Manufacturing Co. v. C. I. T., Madras (supra) viz. that the sum of money had been expended on the ground of commercial expediency and in order indirectly to facilitate the carrying on of the business. We are of the view that the three tests laid down by this Court in the above case viz. (i) that the payment should have been made as a matter of practice which affected the quantum of salary; (ii) that there was an expectation by the employee of getting a gratuity; and (iii) that the sum of money was expended on the ground of commercial expediency and in order indirectly to facilitate the carrying on of the business of the assessee have to be read disjunctively and if they are so read, the present case which satisfies the third test should be held as falling under Section 10(2) (xv) of the Act. The High Court of Gujarat in C. I. T. v. Laxmi Cement Distributors Pvt. Ltd. ((1976) 104 ITR 711 (Guj HC)) and the High Court of Bombay in C. I. T. v. Fairdeal Corporation Pvt. Ltd. ((1977) 108 ITR 280 (Bom HC)) and in C. I. T. v. Patel Cotton Co. Pvt. Ltd. ((1977) 108 ITR 846 (Bom HC)) have also understood the principle underlying the decision of this Court in Gordon Woodroffee Leather Manufacturing Co. v. C. I. T. (supra), in the same way. The High Court was therefore, in error in holding that the amount involved in the case did not satisfy the test applicable to the expenditure allowable under Section 10(2)(xv) of the Act.

21. The next contention urged on behalf of the Department was the since Davids and Tatas were indirectly benefited by the retrenchment of the services of the employees of the Company and payment of compensation to them and since there was no necessity to retrench the services of all the employees, the expenditure in question could not be treated as an expenditure laid out wholly and exclusively for business purposes of the Company. It has to be observed here that the expression "wholly and exclusively" used in Section 10(2)(xv) of the Act does not mean 'necessarily'.

Ordinarily it is for the assessee to decide whether any expenditure should be incurred in the course of his or its business. Such expenditure may be incurred voluntarily and without any necessity and if it is incurred for promoting the business and to earn profits, the assessee can claim deduction under Section 10(2)(xv) of the Act even though there was no compelling necessity to incur such expenditure. It is relevant to refer at this stage to the legislative history of Section 37 of the Income Tax Act, 1961 which corresponds to Section 10(2)(xv) of the Act. An attempt was made in the Income Tax Bill of 1961 to lay down the 'necessity' of the expenditure as a condition for claiming deduction under Section 37. Section 37(1) in the Bill read "any expenditure . . . laid out or expended wholly, necessarily and exclusively for the purposes of the business or profession shall be allowed . . . .". The introduction of the word 'necessarily' in the above section resulted in public protest. Consequently when Section 37 was finally enacted into law, the word 'necessarily' came to be dropped. The fact that somebody other than the assessee is also benefited by the expenditure should not come in the way of an expenditure being allowed by way of deduction under Section 10(2)(xv) of the Act if it satisfies otherwise the tests laid down by law. This view is in accord with the following observations made by this Court in C. I. T. v. Chandulal Keshavlal & Co. Petlad ((1960) 3 SCR 38, 48 : AIR 1960 SC 738 : (1960) 38 ITR 601) :

> Another fact that emerges from these cases is that if the expense is incurred for fostering the business of another only or was made by way of distribution of profits or was wholly gratuitous or for some improper or oblique purpose outside the course of business then the expense is not deductible. In deciding whether payment of money is a deductible expenditure one has to take into consideration questions of commercial expediency and the principles of ordinary commercial trading. If the payment or expenditure is incurred for the purpose of the trade of the assessee it does not matter that the payment may inure to the benefit of a third party (Usher's Wiltshire Brevery Ltd. v. Bruce, (1914) 6 TC 399 (HL)). Another test is whether the transaction is properly entered into as part of the assessee's legitimate commercial undertaking in order to facilitate the carrying on of its business; and it is immaterial that a third party also benefits thereby (Eastern Investments Ltd. v. C. I. T., W. Bengal, AIR 1951 SC 278 : (1951) 20 ITR 1 : 1951 SCR 594). But in every case it is a question of fact whether the expenditure was expend wholly and exclusively for the purpose of trade or business of the assessee.

22. In the instant case, it was the case of the Company that many of the employees were old and superfluous and the business could be carried on with a smaller number and the only way in which they could reduce the number was to terminate the services of all the employees by paying them compensation and thereafter re-employing some of them only. If the Company felt that that was a method which would inure to its benefit, it cannot be said that the payment of compensation was made with an oblique motive and without regard to commercial considerations or expediency. The High Court, therefore, erred on the facts and in the circumstances of the case in holding that the sum of Rs. 1,27,511 was not deductible under Section 10(2)(xv) of the Act and in answering question Nos. (1) and (2) referred to it in Income Tax Reference No. 58 of 1963 arising out of the assessment order for the year 1957-58 against the assessee and in favour of the Department to the extent of Rs. 1,27,511. Similarly it erred in disallowing the claim made in respect of Rs. 16,885 for each of the three succeeding assessment years.

23. We, therefore, allow these appeals and hold that Rs. 1,27,511 was also deductible under Section 10(2)(xv) of the Act during the assessment year 1957-58 and sum of Rs. 16,885 referred to above was allowable as a deduction during each of the three succeeding assessment years. The Department

shall pay costs to the appellant. (Hearing fee one set only).

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